Portfolio Media. Inc. | 860 Broadway, 6th Floor | New York, NY 10003 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

Curbing Contingency Fee Arrangements With State AGs

Law360, New York (February 13, 2015, 2:54 PM ET) --

Zia C. Oatley

Attorneys representing defendants in environmental enforcement actions may expect their opposing counsel to be a public employee of a federal, state or county attorney general's office. Imagine, however, finding yourself across the table from a private plaintiffs' attorney, and one whose compensation is tied directly to the amount of the judgment levied against or settlement extracted from your client. This is a real possibility in some jurisdictions — and one experienced by the author in recent litigation.

This article describes several areas, including environmental enforcement actions, where attorneys general have retained private plaintiffs' attorneys on a contingent fee basis to prosecute public causes of action. The article then discusses challenges defendants have raised to contingent fee arrangements in public enforcement actions and summarizes the general lack of success of these challenges. The article concludes by highlighting transparency initiatives aimed at urging government attorneys to adopt best practices in retaining private plaintiffs' attorneys to pursue public enforcement actions.

Use of Contingent Fee Arrangements in Public Enforcement Actions

It is reported that well-known plaintiffs' lawyer Dickie Scruggs first came up with the idea of bringing public enforcement actions against corporate defendants using contingent fee arrangements. In the mid-1990s, states were dealing with the fallout of their residents smoking, including the medical costs of caring for smokers eligible for public assistance programs. Dickie Scruggs proposed to Mississippi Attorney General Mike Moore that he would sue the tobacco companies on behalf of Mississippi to recover the costs of care for the state's smokers as well as penalties. But, rather than retaining Scruggs and his firm on an hourly basis, Scruggs proposed he be paid a share of the recovery in the suit. Moore agreed, and Scruggs' firm was retained on a contingent fee basis. Other states signed on to this arrangement and, at the end of the day, Scruggs walked away with more than $1 billion in fees from the tobacco litigation.

Supporters of contingent fee arrangements in public enforcement actions justify their use on the grounds that these arrangements allow states and localities "to bring suits on behalf of the citizens of their states that would otherwise be impossible due to a lack of personnel resources, expertise and money."[1] The arguments defendants have raised against the use of contingent fee arrangements are discussed in the

section below. Regardless of the merits, use of private attorneys to prosecute public actions on a contingent fee basis is now a prevalent part of the legal landscape.

Actions by States for CERCLA Natural Resource Damages

Use of contingent fee arrangements became common in Comprehensive Environmental Response, Compensation, and Liability Act natural resource damages cases beginning in the early 2000s.[2] New Jersey became the model for use of these arrangements. In 2003, the commissioner of the New Jersey Department of Environmental Protection published a policy directive, which communicated the state's plan to collect natural resource damages at thousands of the state's contaminated sites.[3] The state utilized private plaintiffs' counsel to pursue these actions, which included a claim for $950 million in natural resource damages from more than 60 companies alleged to have contributed to contamination in the lower Passaic River.[4] Other states, including New Mexico, have retained plaintiffs' firms on contingency to bring NRD claims.[5]

Actions by States Against Pharmaceutical Companies

More recently, there has been a wave of lawsuits brought by private plaintiffs' lawyers on behalf of states against pharmaceutical companies alleging violations of consumer protection law or unfair trade practices.[6] Depending on the theory of liability, these lawsuits may seek to recover state expenditures for the prescriptions and/or civil penalties. For example, in 2009, Kentucky's attorney general retained a private firm to sue Merck & Co. Inc. concerning its marketing and distribution of Vioxx. The lawsuit alleged Merck violated the Kentucky Consumer Protection Act, and sought civil penalties of $2,000 per violation, and $10,000 per violation targeted to consumers over the age of 65.[7] In another case, Connecticut sued Eli Lilly and Co. under the federal Racketeer Influenced and Corrupt Organizations Act statute and the Connecticut Unfair Trade Practices Act, and sought both a refund of the amount paid for the drug Zyprexa through public assistance programs, the costs incurred to treat Medicaid recipients whose diabetes was allegedly caused by Zyprexa and statutory penalties of up to $5,000 for every Zyprexa prescription written to a Connecticut resident since the drug's launch.[8]

Actions Seeking Civil Penalties for Violations of Environmental Statutes

Following the model of the state actions discussed above, at least one county has now joined the game. Since 2010, Harris County, Texas, retained a single private law firm on a contingent fee basis to pursue three separate civil penalty actions, all of which allege that the historical operations of several corporate defendants contaminated portions of Harris County.[9] These lawsuits are notable because Harris County brought these suits against parties who were already cleaning up the sites at issue in the litigation. Before these cases, the state had taken the de facto position that it would not seek civil penalties from parties cooperating in environmental cleanups. Nevertheless, Harris County (and its private attorneys) pursued these cases.

Defense Challenges to Contingent Fee Arrangements in Public Enforcement Actions

Defendants have challenged the use of contingent fee arrangement on various grounds, with mixed results.

First, defendants argue that use of contingent fee arrangements violates the separation of powers doctrine. One vein of this argument contends that because in a contingent fee arrangement, a portion of the state's recovery goes to the lawyers, the attorney general — a member of the executive branch — appropriates state resources, which is a role reserved for the legislative branch.[10] Another variation of this argument

contends that hiring contingent fee counsel "circumvents the legislative process by enabling the executive branch to bypass the legislative body that normally would have to appropriate funds to prosecute litigation."[11] Second, defendants argue that by delegating the government's coercive powers to private attorneys who have a direct financial stake in the outcome, the defendant's due process rights to a neutral prosecutor have been violated.[12] Third, some defendants argue that contingent fee arrangements are inconsistent with the underlying substantive causes of action, either because the state attorney general purportedly lacks the authority to delegate authority to private counsel, or because the statute requires all recovered moneys to be allocated to a specific purpose (that is, none of the recovered funds can be used to pay the lawyers).

These challenges have had mixed success. In an early case, the California Supreme Court invalidated the attorney general's delegation of power to pursue a public nuisance action to a private attorney paid through a contingent fee arrangement. The court explained that government lawyers have a "duty of neutrality," and when "a government attorney has a personal interest in the litigation, the neutrality so essential to the system is violated," and the attorney must be disqualified from the representation. For the same reason, the court explained that a private attorney who has a financial interest in the outcome of the litigation must likewise be disqualified — at least in the context of a public nuisance claim.[14]

Since this early victory, however, courts have become more permissive of contingent fee arrangements. Although some courts affirm the idea that private attorneys must "satisfy the principles of neutrality which apply to attorneys prosecuting cases on behalf of the government" (Merck Order at 8), in practice courts find contingent fee arrangements to comply with the duty of neutrality so long as the contract states that the government retains control of the litigation.[15]

Sunlight Initiatives

In addition to the legal challenges discussed above, contingent fee arrangements are criticized as creating ethical and conflict-of-interest problems. State or county attorneys general make the decision on which law firms to hire. Many of these attorneys general must also run for office, and there is a concern that these lucrative contingent fee contracts are awarded in return for campaign contributions or support.[16]

In response to these criticisms, several states have enacted reforms. According to the American Legislative Exchange Counsel, the organization that drafted the model Private Attorney Retention Sunshine Act, 10 states have passed legislation concerning retention of private attorneys.[17] For example, Mississippi — the home state of Dickie Scruggs — passed a Sunshine Act that allows the attorney general to continue hiring outside counsel, but requires the private lawyers to keep detailed time records, and their hourly rates cannot exceed "recognized bar rates."[18] In addition, although the attorney general may still hire attorneys on a contingent fee basis, the amount of fees is capped at 25 percent of a $10 million recovery, 20 percent for recoveries between $10 million to $15 million, and 5 percent for amounts over $25 million, with an overall cap of $50 million.

Conclusion

Although a relatively recent innovation, use of contingent fee counsel has become a prevalent tool for state and county attorneys general. Moreover, given the lack of success of legal challenges to contingent fee arrangements, state legislation aimed at curbing abuses appears to be the source of limits to these arrangements.

—By Zia C. Oatley, Gibson Dunn & Crutcher LLP

DISCLOSURE: The author represented International Paper in the Harris County case.

Zia Oatley is an associate in Gibson Dunn & Crutcher's Washington, D.C., office.

[1] L. Godesky, State Attorneys General and Contingency Fee Arrangements: An Affront to the Neutrality Doctrine?, 42 Colum. J. of L. & Social Problems 587, 588 (2009).

[2] The first known instance of a contingent fee arrangement in connection with a CERCLA natural resource damage claim arose in the U.S. Virgin Islands. The territory retained "well-known plaintiff's lawyer John K. Dema" to recover damages from various oil companies "for contamination of the Tutu Wellfields, the sole source of drinking water in St. Thomas." P. Gray, The Rise of Natural Resource Damage Claims[:] States and Plaintiffs' Attorneys Leading the Charge, Am. Bar Ass'n, Section of Env't, Energy & Res. (citing In re Tutu Water Wells Contamination Litig., 78 F. Supp. 2d 423 (D.V.I. 1999)).

[3] NJDEP, Policy Directive 2003-07, available at www.nj.gov/dep/commissioner/policy/pdir2003-07.htm.

[4] J. Steiner, The Illegality of Contingency-Fee Arrangements When Prosecuting Natural Resource Damage Claims and the Need for Legislative Reform, 32 Wm. & Mary Envtl. L & Pol'y Rev. 169, 169 n.8 (2007).

[5] New Mexico v. Gen. Elec. Co., 335 F. Supp. 2d 1185 (D.N.M. 2004), aff'd, 467 F.3d 1223 (10th Cir. 2006).

[6] N. Gussak and R. Ray, The New AG Case: Defending Cases Where There Is an Alliance Between an Attorney General and the Plaintiffs' Bar, at 225 (discussing cases brought in South Carolina, Texas, Utah, and South Carolina).

[7] Compl., Commonwealth ex rel. Conway v. Merck & Co., Inc. (Franklin Cir. Ct. Sept. 28, 2009).

[8] State of Connecticut v. Eli Lilly & Co., CV 08-955 (E.D.N.Y. Mar. 6, 2008).

[9] The lawsuits are Harris County v. AT&T Servs. Inc., Cause No. 2011-72150 (Harris County Dist. Ct.) (seeking daily penalty for allegedly leaking underground storage tank); Harris County v. PMSV River Oaks LP et al., Cause No. 2011-52524 (Harris County Dist. Ct.) (seeking daily penalty for historical contamination from dry cleaning operation); and Harris County v. International Paper et al., Cause No. 2011-76724 (Harris County Dist. Ct.) (seeking daily penalties from 1968 through 2008 for paper mill waste disposed of in 1967).

[10] See, e.g., Op., Int'l Paper Co. et al., v. Harris County, No. 01-12-00538-cv (Tex. Ct. App., 1st Dist., July 25, 2013), at 11-12.

[11] D. Axelrad and L. Perrochet, The Supreme Court of California Rules on Santa Clara Contingency Fee Issue – Backpedals on Clancey, at 340.

[12] See, e.g., Mem. Op. & Order, Merck Sharp & Dohme Corp. v. Conway, 3:11-51 (E.D.Ky. May 24, 2013).

[13] People ex rel. Clancy v. Superior Court, 39 Cal.3d 740 (Cal. 1985).

[14] Id. (“Thus we hold that the contingent fee arrangement between the city and Clancey is antithetical to the standard of neutrality that an attorney representing the government must meet when prosecuting a public nuisance abatement action.).

[15] Godesky, supra note i, at 590.

[16] See, e.g., U.S. Chamber, Institute for Legal Reform, Privatizing Public Enforcement (Sept. 2013), at 5-6 (quoting former attorney general who has been an outspoken critic of contingent fee arrangements as saying “[t]hese contracts ... create the potential for outrageous windfalls or even outright corruption for political supports of the officials who negotiated the contracts.”).

[17] See http://www.alec.org/initiatives/sunshine-in-state-attorney-contracts/.

[18] See Mississippi House Bill 211 (“the Sunshine Act”), discussed at http://www.governorbryant.com/gov-phil-bryant-signs-sunshine-act/.
